Fair Political Practices Commission
MEMORANDUM

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin and Remy

From: Lawrence T. Woodlock, Senior Commission Counsel
Luisa Menchaca, General Counsel

Subject: Adoption of Regulation 18530.3 on Reporting Mixed State and Federal Expenditures by Political Party Committees, and Regulation 18534 on Required Committee Bank Accounts.

Date: November 27, 2006

Executive Summary

At the September prenotice discussion of regulation 18530.3, the Commission considered two distinct approaches, a draft written by staff, and a second one offered by Mr. Charles H. Bell as an alternative. After lengthy debate, the Commission directed staff to return for adoption of a regulation based on Mr. Bell's alternative, but including a provision from subdivision (a) of staff's version, specifying that state contribution limits applied to contributions made to federal Levin Fund accounts when the contributions were made for the purpose of making contributions towards the support or defeat of candidates for elective state office. Attachment One is the text of the regulation now proposed for adoption. Attachment Two is the "marked up" text of Mr. Bell's original draft, showing in detail how Attachment One was developed from Mr. Bell's language.

Also in September, the Commission considered proposed regulation 18534, whose function is to support the contribution limits of section 85303. That statute imposes contribution limits on all committees when a contribution is made or received "for the purpose of making contributions to candidates for elective state office." This statute does not limit contributions made for any other purpose. To police compliance with this contribution limit, staff proposed that contributions in excess of the limit be segregated in a separate bank account from funds legitimately available for any and all purposes. Here too there was lively and productive discussion, and the Commission directed staff to return for adoption of the regulation, with a number of specific changes to the prenotice draft. Attachment Three is the resulting text of regulation 18534.

Staff recommends adoption of both regulations, as explained below.

1. Regulation 18530.3

Background

California political party committees are defined by the Act[1] at section 85205:

> "'Political party committee' means the state central committee or county central committee of an organization that meets the requirements for recognition as a political party pursuant to Section 5100 of the Elections Code."

These committees typically maintain from two to four bank accounts, which may be registered as committees in their own right under state or federal law, depending on their sphere of activity. Thus a county central committee may receive and direct contributions into a "federal account," subject to the source and amount limitations and the reporting requirements of the Federal Election Campaign Act (the "FECA"), which regulates funds used in federal political activities. The same committee may also receive and direct contributions into one or more "non-federal accounts," subject to the limits and reporting requirements of the Act, which regulate funds used for state and local activities. Further, federal law permits political party committees to establish and maintain "Levin fund" and "allocation" accounts, to collect and disburse funds used for a mix of federal and state or local campaign activities.

The rules governing activities by California political party committees are well established insofar as they concern only state or local activities. But when these committees engage in activities regulated in part by our own Act, and in part by the FECA, the interplay between these two bodies of law is not always clearly outlined in federal or state law. Many of the disputes in this area were settled by the Commission in September. But there may still be some lingering controversy over application of state contribution limits to federal "Levin Fund" accounts, and for that reason a brief excursus into the pertinent federal law may be useful.

One of Congress' reasons for passing BCRA was to limit the role of "soft money" in federal elections.[2] A legislative compromise, the "Levin Amendment," attempted to reaffirm the traditional role of "soft money" by permitting contributions up to $10,000 per person per year to every federal political party committee, subject to strict limits on the usage of "Levin funds," as described at 11 CFR part 300 and summarized below.

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[1] Government Code sections 81000 – 91014. Commission regulations appear at title 2, sections 18109-18997, of the California Code of Regulations.

[2] "Soft money" refers to funds that could be donated to political parties without limit, ostensibly for use in traditional get-out-the-vote and other generic party-building activities, which nonetheless came to be used in the last decade overtly to fund federal election campaigns. Contributions intended for use in election campaigns ("hard money") were subject to strict limits whose utility was compromised by the surge in "soft money" campaigns.

State and local political party committees that have receipts or make disbursements for "federal election activities" (as defined in the FECA) may create up to four types of accounts: (1) a *federal account* for deposit of funds raised in compliance with FECA; (2) a *non-federal account* for deposit of funds governed entirely by state law; (3) an *allocation account* from which payments are made that may be allocated to both state and federal uses; and (4) a *Levin account*, for deposit of funds that comply with some of the limits and prohibitions of FECA, but are also governed by state law. A committee may have several non-federal accounts.[3]

Levin funds may only be spent by the committee that raises them, and only on certain activities. The general rule is that state and local party committees must use federal funds to make expenditures and disbursements for any federal election activity. However, they may use Levin funds to pay for voter registration activity during the 120 days prior to a regularly scheduled federal election, along with generic campaign activity, voter identification, and get-out-the-vote drives run in connection with an election in which a federal candidate appears on the ballot. These are uses to which "soft money" was traditionally directed in the federal system.

Expenditures on federal election activities totaling more than $5,000 per annum must be paid entirely from a committee's federal account, or allocated between its federal, Levin and state accounts under formulas based on the candidates appearing on the federal ballot, which dictate a minimum federal allocation that serves as a "floor" that prevents under-estimation of federal expenditures. The rules are as follows:

(1) If a presidential candidate, but no senate candidate appears on the ballot, then at least 28 percent of any mixed federal-state expenditure must be allocated to the federal account;
(2) If both a presidential and a senatorial candidate appear on the ballot, then at least 36 percent of the expenditure must be allocated to the federal account;
(3) If a senate candidate, but no presidential candidate appears on the ballot, then at least 21 percent of the expenses must be allocated to the federal account;
(4) If neither a presidential nor a senatorial candidate appears on the ballot, the minimum federal allocation is 15 percent.[4]

Levin funds may *not* be used to pay for any part of a federal election activity that

[3] A committee with separate federal and non-federal accounts may pay mixed federal/state expenditures in three ways. It can make the payment straight out of the federal account, with or without subsequent reimbursement by the non-federal account of the portion allocable to the state or local activity. It can set up an "allocation account" under 11 CFR section 106.5(g)(2), to receive deposits from the federal and non-federal accounts in the amount allocated to each as its share of the total expenditure, which is then paid out of this account. Or it can pay for certain kinds of expenditures out of a "Levin" account.

[4] Prior discussion of the problem treated in the *Boling* Advice Letter (No. A-04-212) emphasized that these minimum formulas can and do result in "subsidies" from federal party accounts, other than Levin accounts, to state and local party committees. Although the bulk of this discussion is devoted to Levin Fund accounts, the Commission should bear in mind that the requirement of fixed minimum payments from federal accounts towards campaign advertisements that include state and local candidates can result in what are effectively federal subsidies of state and local campaign expenditures – subsidies that may be provided by federal committee bank accounts separate and apart from their Levin Fund accounts.

refers to a clearly identified *federal* candidate, or for any television or radio communication, unless it refers solely to a clearly-identified state or local candidate. Levin funds also may not be used to pay any person who devotes more than 25% of compensated time in connection with a federal election. It is worth emphasizing that Levin funds (like other federal party funds) can be used to pay for communications, including television and radio advertisements, which refer to clearly identified *state* candidates.

Each state and local party committee has a separate Levin fund contribution limit of $10,000 per person per annum. Levin funds must be raised and spent by the committee that maintains the particular account. Transfers and joint fundraisers are prohibited. Generally, fundraising costs may not be allocated, and no non-federal funds may be used to pay direct fundraising costs; non-federal and Levin funds must be raised using non-federal or Levin funds.

It appears that at least some committees believe that Levin funds raised by a state or local political party committee do not count against the $27,900 annual contribution limit established by section 85303(b). This claim seems to be founded on a federal regulation governing receipt of Levin funds, 11 CFR 300.31(d)(2), which provides:

> "*Effect of different State limitations*. If the laws of the State in which a State, district, or local committee of a political party is organized limit donations to that committee to less than the amount [$10,000] specified in paragraph (d)(1) of this section, then the State law amount limitations shall control. If the laws of the State in which a State, district, or local committee of a political party is organized permit donations to that committee in amounts greater than the amount specified in paragraph (d)(1) of this section, then the amount limitations in paragraph (d)(1) shall control."

The parties apparently agree that California could limit contributions to party committees to $5,000, and that the limit on Levin fund contributions would thereby shrink to a maximum of $5,000. The parties may argue that this is the *only* fashion in which state law limits donations to Levin accounts. But staff believes that section 85303(b) *does* operate to limit contributions to a Levin account. Specifically, if a person has donated to a party committee the maximum ($27, 900) sum permissible under section 85303(b), a later contribution to the party's Levin fund would exceed that limit if it were made or accepted "for the purpose of making contributions for the support or defeat of candidates for elective state office." To argue otherwise, the parties would have to maintain that passage of the Levin amendment actually increased California's limit on contributions supporting candidates for state elective office – from $27,900 to $37,900.

There is no basis for such an interpretation of a federal law whose express position is that the collection of Levin funds is subject to the limits imposed by state law.[5]

The Proposed Text of Regulation 18530.3

The regulation presented for adoption (Attachment One) establishes rules for reporting – on California forms – certain contributions to, and expenditures from, Levin Fund accounts maintained by California political party committees.

The final sentence of subdivision (a) is meant to make clear, as the Commission requested, that the contribution limit set by section 85303(b) includes contributions made to a committee's Levin Fund accounts, when the contributions are made for the purpose of making contributions for the support or defeat of candidates for elective state office. Some political party committees may continue to dispute this construction of the law, but the Commission accepted staff's position in September, and that position is accordingly made explicit in subdivision (a).

The *disclosure* scheme reflected in this regulation is modeled on the proposal submitted to the Commission last September by Mr. Bell, with certain modifications of language that staff does not regard as altering the substance of the proposal. The precise modifications to Mr. Bell's draft are shown in Attachment Two. The Commission accepted Mr. Bell's scheme as a reasonable compromise between the state's interest in disclosure of campaign activities affecting state and local election contests, as against the burdens of providing additional information whose practical utility seemed marginal.

Under the regulation now up for adoption, all contributions to a political party committee's Levin Fund account will be disclosed on the committee's state campaign reports, if the contributions are used to make contributions for the purpose of supporting or defeating any state or local candidate or ballot measure. (Subd. (a).) Committees will likewise report expenditures of Levin Funds made for the same purposes. (Subd. (b).)

Subdivision (b) includes as Option 2 a variant on Mr. Bell's treatment of Levin Fund expenditures, replacing the original object of the sentence ("any Federal Levin Fund expenditures…") with "expenditures from any account established and maintained under provisions…" of federal law. This broader term would include the federal "subsidies" that were treated in the *Boling* Advice Letter, which came from federal party committees that did not have Levin Fund accounts.

[5] Subdivsion (b) of 11 CFR 300.31 provides that: "Each donation of Levin funds solicited or accepted by a State, district, or local committee of a political party must be lawful under the laws of the state in which the committee is organized." If a donor has already contributed the maximum allowed under section 85303(b), it is difficult to see how this federal regulation could be read to permit a donor to contribute an *additional* $10,000 to the same committee's Levin account specifically "for the purpose of making contributions for the support or defeat of candidates for state elective office."

Staff recommends this Option because it would provide accessible instruction to the regulated community not only on how to report what amounts to contributions from Levin Fund accounts, but tells them how to report the kind of "subsidies" (from federal party accounts other than Levin Fund accounts) discussed in the *Boling* Advice Letter which, to date, has not been codified in a separate regulation. There is no principled basis for a distinction between expenditures from any federal committee accounts. If they are made to support or defeat state or local candidates or ballot measures, these expenditures should be disclosed in the same fashion, and the requirement should be stated in a single regulation. Indeed, subdivision (c), which has not been modified from Mr. Bell's original draft, is not limited to federal party expenditures from particular accounts, and Option 2 actually aligns subdivision (b) with subdivision (c), which provides that the committee need not itemize (or "allocate" to individual contributors) the contributions to federal committee accounts from which state-reportable expenditures or contributions are made.

Subdivision (d) requires disclosure of contributions to a Levin Fund account by a committee described in section 82013, and subdivision (e) requires party committees to provide "major donor notices" for donors to contributors disclosed under subdivision (a).

2. Regulation 18534

Draft regulation 18534 (Attachment Three) is staff's attempt to implement the Commission's directions in light of the public discussion last December. "Options" are not marked off as such in this draft. Because the Commission gave sufficient direction at the prior meeting, it will be more convenient to proceed through the regulation in order, identifying and discussing the revisions that were requested by the Commission.

Like regulation 18530.3, regulation 18534 also implements the contribution limits of section 85303, but is broader in scope because it governs not only the limits imposed on political party committees in section 85303 (b), but also those governing all other recipient committees that make contributions to state candidates, in section 85303(a). The limits set by both subdivisions of section 85303 apply only to certain contributions, those intended for use in campaigns for elective state office. Contributions to committees intended to support or oppose candidates for *other* elective offices, and contributions to committees made for any other purpose, are *not* limited by section 85303.

As described in prior memoranda, because the contributions that a committee receives are limited in some cases and not limited in others, it is important immediately upon receipt to segregate funds that are subject to limits from those that are not. The only way to avoid the commingling of limited and unlimited contributions in a single account is the segregation of funds contributed for these different purposes. The commingling of these funds at any point would make contribution limits virtually unenforceable because the source of funds expended from a commingled account cannot readily be established. The proposal to require at least one bank account specifically identified as the repository of contributions subject to the limits of section 85303 was

accepted by all persons in attendance at Commission meetings on the subject.

The following paragraphs offer a brief overview of the evolution of specific provisions, which will be followed by a short summary of the terms actually present in each subdivision now before the Commission.

Staff has abandoned the naming conventions originally presented in the draft regulation ("candidate support" vs. "non-candidate support" accounts). The public found this nomenclature confusing. Last December the Commission requested that staff require a "general" account for deposit of limited funds, which could be used as the sole, "default" account by any committee that did not anticipate contributions in excess of contribution limits. Upon review, staff found that the term "general" itself caused confusion, since it was not obvious to everyone whether the term meant that the money could be used for everything *but* the narrow purposes subject to contribution limits, or for absolutely every purpose. For these reasons staff suggested in September use of the terms "all purpose" and "restricted use," to eliminate a kind of ambiguity that appeared in most alternatives. Although this choice did not meet with universal acclaim, the Commission tentatively agreed on this convention for want of a better option.

The original version of this regulation specified that the pertinent nomenclature be included in the account names printed on the checks, but the Commission preferred to drop the requirement that the account names be "printed," to accommodate circumstances when a committee did not have pre-printed checks. The words "printed on the check" have accordingly been replaced throughout the regulation by the words "appearing on the check," to eliminate this perceived difficulty.

At the most recent (September) meeting, Ms. Boling asked for a new exception applicable to a small committee with an "all purpose" account set up to receive credit card contributions. Such credit card arrangements were costly, she explained, and these committees would save money if they were permitted to accept over-limit contributions into "all purpose" accounts, so long as they "made the pot right" within a stated period of time. The contrary argument, that such an exception ran counter to the core purpose of the regulation, and that the committees could avoid the problem either by communication with their donors, or by switching credit card access to the "restricted use" account, was accepted by the Commission, which did not ask staff to return with draft language for such an exception.

The Commission did entertain a proposal from Mr. Bell for draft language that would permit recipients of earmarked contributions an opportunity to elicit letters from the donors disclaiming the originally-stated purpose, in order to avoid the requirement of then-subdivision (d) that called for return of over-limit contributions earmarked for state candidate purposes. However, that requirement was not in Mr. Bell's draft regulation, from which the present version grew, and the offending requirement no longer appears in the regulation before the Commission. This exception, therefore, is no longer necessary.

Summary by Subdivision: Regulation 18534

Subdivision (a)

This provision simply states the scope of the regulation, was uncontroversial in September, and is unchanged from the September version.

Subdivision (b)

This subdivision introduces the name and permissible uses of the "all purpose" account. As noted earlier, the language of this subdivision is unchanged since September, except for the substitution of the word "appearing" for "printed," which is intended to relieve difficulties experienced by new committees before they receive printed checks.

Subdivision (c)

This subdivision introduces the "restricted use" account, states permissible uses of funds from these accounts, and describes in some detail the use of such an account to receive over-limit checks (if such checks are not "split" at time of deposit) for subsequent transfer to an "all purpose" account of a sum not to exceed the contributor's limit under section 85303(a) or (b). The first two sentences are unchanged from September, but for the substitution of "Any contribution" for "Contributions" at the beginning. This is a stylistic alteration without substantive effect.

The third sentence is new, specifying that the committee keep records sufficient to establish that transfers to an "all purpose" account were completed within the time permitted under this subsection. There is no reason to believe that the Act's existing committee recordkeeping provisions would not require such documentation, but the Enforcement Division thought it advisable to invest a few words to ensure that there will be no inadvertent violations. The final sentence, requiring that the words "restricted use" be included in the name of the account appearing on the check, is carried over from September, omitting the prior requirement that the account name be *printed* on the check.

Subdivision (d)

This subdivision is entirely new. In the version that the Commission saw in September, subdivision (d) required return of checks in excess of the contributor's limits under section 85303(a) or (b), if the check was earmarked for uses subject to those limits. Upon request from the regulated community, the Commission directed staff to draft an exception to the "earmarking" return requirement, permitting the recipient to procure a letter from the donor disavowing the previously stated intent.

In reviewing the subject of donor intent, staff recognized that one goal of section

85303 is to limit the amount of money that a donor may contribute for purposes stated specifically in the statute. But donors do not earmark each and every contribution, and would quickly learn *not* to earmark large donations if, by so doing, they might evade the limits of section 85303. Accordingly, if section 85303 is to have real force and effect, it must be understood to limit the funds *accepted* for purposes mentioned in the statute.

In other words, whether funds are "earmarked" by the donor or by the recipient, the result is the same under this regulation. Funds made available to further the purposes governed by section 85303 are deposited into segregated accounts, in sums not exceeding the statutory limit. To give effect to the statute, it is unnecessary to determine w*hose* purpose underlies the decision to place the funds in the "all purpose" account, still less to mediate misunderstandings or disputes between donor and recipient. So long as contributions destined for purposes mentioned in section 85303 are deposited in amounts not exceeding the prescribed levels, the statutory mandate is satisfied. Thus, while section 85303 limits the amount that can be contributed for certain purposes, it does not follow that the statute provides authority for a requirement that the recipient *return* contributions earmarked for another purpose, or "clear" the intended use of funds with the donor.

The original earmarking provision was therefore dropped from the regulation, and was replaced by a provision that expressly announces that funds from "restricted use" accounts may not be used for the purposes stated in section 85303. Such a provision is implicit in subdivision (b), which states that only funds from "all purpose" accounts may be spend for such purposes. But many users will turn to this regulation to answer specific questions involving "restricted use" accounts, and staff believes that an express statement of the uses permitted for funds from "restricted use" accounts should be included in the regulation, to insure that the implication of subdivision (b) is not overlooked by persons who are not interested in the "all purpose" accounts discussed in subdivision (b).

Subdivision (d) specifies that the purposes subject to section 85303 include the purpose of raising funds to make contributions to candidates for elective state office, or to raise funds that will be used to make contributions to candidates for elective state office. This statement may be too explicit for some members of the regulated community, but the rule appears to be required by the plain meaning of the statute, which limits contributions made for the purpose of making contributions.[6] This language cannot be read simply as referring to a situation where a committee takes in a contribution earmarked by a donor, and reissues a contribution check pursuant to the donor's wishes – in such a transaction the original donor would remain the donor, with the committee serving as intermediary.

At a minimum, section 85303 *must* govern contributions from donors who expect the committee to exercise discretion or expertise in using funds coming in to make contri-

[6] The Act includes its own rule for interpreting its provisions, at section 81003: "This title should be liberally construed to accomplish its purposes." Constructions of section 85303 that defeat or limit its effect must therefore be avoided.

butions that will advance the common interest of donor and recipient. Donor reliance on the committee's expertise makes the committee something more than an intermediary.

Section 85303 would not be rendered moot if a committee, in its wisdom, should choose to invest the money in an interest-bearing account, with an eye to increasing the size of the eventual contributions. In most cases, this would be expected behavior. Contributions towards a candidate fundraiser are no different, when the proceeds ("principle and interest") are used to make contributions to candidates for elective state office. In both cases, the purpose of the contributions is the same; only the means of serving that purpose are different – but the application of the statute is triggered by the *purpose* of the contributions, not the means whereby the purpose is accomplished.

Subdivisions (e) (f) and (g)

Apart from a few stylistic changes without substantive effect, these provisions are identical to those before the Commission in September. They were not the subject of controversy at that time. **(Note: Subd. (e) appears completely superfluous, since it merely restates what is already stated in subd. (b).)**

Recommendation

Staff recommends that the Commission adopt both regulation 18530.3 (with the language from Option 2) and regulation 18534.

Attachments:

Draft regulation 18530.3
Draft regulation 18530.3 illustrating departures from Mr. Bell's proposal
Draft regulation 18534